

# Inspector General

United States  
Department of Defense



## Utility Tax Avoidance Program in Germany

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## Acronyms and Abbreviations

DFAS	Defense Finance and Accounting Service
DODEA	Department of Defense Education Activity
IMCOM-E	Installation Management Command - Europe Region
LQA	Living Quarters Allowance
TRO	Tax Relief Office
USD(P&R)	Under Secretary of Defense for Personnel and Readiness
USAFE	United States Air Forces in Europe
UTAP	Utility Tax Avoidance Program
VAT	Value Added Tax



INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
400 ARMY NAVY DRIVE  
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September 29, 2010

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR PERSONNEL  
AND READINESS  
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

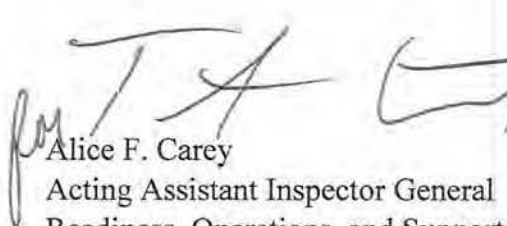
SUBJECT: Utility Tax Avoidance Program in Germany  
(Report No. D-2010-086)

We are providing this report for review and comment. We considered management comments on a draft of this report when preparing the final report. DOD could avoid paying at least \$2.8 million in foreign taxes by requiring eligible civilians to participate in the Utility Tax Avoidance Program.

DOD Directive 7650.3 requires that all recommendations be resolved promptly. The Under Secretary of Defense for Personnel and Readiness comments were responsive on Recommendations 1 and 2. We redirected Recommendation 3 to the Under Secretary of Defense for Personnel and Readiness. Therefore, we request additional comments on Recommendation 3 by October 29, 2010.

If possible, please send a .pdf file containing your comments to [audros@dodig.mil](mailto:audros@dodig.mil). Copies of your comments must have the actual signature of the authorizing official for your organization. We are unable to accept the /Signed/ symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Please direct questions to Donald A. Bloomer at (703) 604-8863 (DSN 664-8863).

  
Alice F. Carey  
Acting Assistant Inspector General  
Readiness, Operations, and Support





# Results in Brief: Utility Tax Avoidance Program in Germany

## What We Did

Our objective was to determine whether DOD is effectively using the Utility Tax Avoidance Program in Germany and the Netherlands. This report addresses the Utility Tax Avoidance Program in Germany, and Report No. D-2010-0030, "Utility Tax Relief Program in the Netherlands," January 6, 2010, addresses the Netherlands. The Utility Tax Avoidance Program allows eligible personnel to avoid paying Value Added Tax on their residential consumption of electricity, gas, and water. The Commander, U.S. Army Europe is the designated Military Commander for the purpose of the Foreign Tax Relief Program in Germany.

## What We Found

DOD was not effectively using the Utility Tax Avoidance Program in Germany. This occurred because DOD did not require eligible civilian personnel to participate in the program. Between March 2008 and February 2009, DOD paid \$58 million in living quarters allowance for utility-related items. We identified potential monetary benefits of \$512,019 for utility-related payments to Army civilians during the 12-month period ending February 28, 2009. As a result, we estimated that DOD could avoid paying at least \$2.8 million in foreign taxes over the Future Years Defense Program by requiring eligible civilians to participate in the Utility Tax Avoidance Program.

## What We Recommend

We recommend that the Under Secretary of Defense for Personnel and Readiness:

- develop regulatory guidance requiring civilian personnel agencies to withhold living quarters allowance until recipients

submit proof of participation or ineligibility for the utility tax avoidance program;

- develop regulatory guidance reimbursing living quarters allowance recipients for enrollment fees; and
- develop a standard form for tax relief offices to complete, which will prove living quarters allowance recipients' participation or ineligibility for the utility tax avoidance program in coordination with the Regional Director, U.S. Army Installation Management Command - Europe Region.

## Management Comments and Our Response

The Under Secretary of Defense for Personnel and Readiness provided comments that were responsive to draft Recommendations 1.a. and 1.b.. As a result of management comments, we redirected Draft recommendation 2 to the Under Secretary of Defense of Personnel and Readiness. As a result, Draft Recommendations 1.a., 1.b. and 2 have been renumbered as Recommendations 1, 2, and 3, respectively. We request comments to the final report by October 29, 2010.

The Regional Director, U.S. Army Installation Management Command - Europe Region comments were responsive.

Please see the recommendations table on the back of this page.



## Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Under Secretary of Defense for Personnel and Readiness	3.	1. and 2.

**Please provide comments by October 29, 2010.**

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# Introduction

## Audit Objective

Our objective was to determine whether DOD is effectively using the Utility Tax Avoidance Program (UTAP) in Germany and the Netherlands. This report addresses the UTAP in Germany, and Report No. D-2010-0030, “Utility Tax Relief Program in the Netherlands,” January 6, 2010, addresses the Netherlands. See Appendix A for a discussion of the scope and methodology.

## Background on Utility Tax Avoidance Program

DOD Instruction 5100.64, “DOD Foreign Tax Relief Program,” March 30, 2006, requires that DOD make a concerted effort to secure effective tax relief from foreign taxes where practical. Furthermore, DOD Instruction 5100.64 requires the Commander of each Combatant Command to designate a single military commander as the point of contact for tax relief matters for each foreign country. Per DOD Instruction 5100.64, the Commander, U.S. European Command assigned the Commander, U.S. Army Europe as the designated Military Commander for the purpose of the Foreign Tax Relief Program in Germany. Army in Europe Regulation 215-6, “Individual Tax-Relief Program,” August 3, 2009, assigned the Installation Management Command – Europe Region (IMCOM-E) as the administrator of tax-relief policies, procedures, and pricing in Germany.

Pursuant to DOD Instruction 5100.64, IMCOM-E established the DOD UTAP in conjunction with the United States Air Forces in Europe (USAFE) Services Agency. UTAP allows eligible DOD personnel<sup>1</sup> to avoid paying Value Added Tax (VAT) on their residential consumption of electricity, gas, and water. VAT ranged from 7 percent to 19 percent. In January 2007, VAT rates for energy related products/utilities changed to 19 percent for electricity and natural gas, and 7 percent for water. See Appendix B for criteria that pertain to foreign tax relief.

## Eligibility

All DOD personnel who receive full logistical support<sup>2</sup> and reside in off-post housing in Germany may be eligible to participate in the UTAP. Army in Europe Regulation 215-6 identifies the following eligibility criteria:

- Individuals must receive their utilities from a provider that has a contractual agreement with the tax relief office (TRO) to provide tax-free utilities;

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<sup>1</sup> For the purpose of this report, “DOD personnel” refers to both military and civilian personnel.

<sup>2</sup> Full logistical support includes 23 items (or privileges) to include Commissary and Military Exchange privileges.

- Individuals must receive electricity, gas, and water in a subscription-style, recurring basis over several months or years; and
- Individuals must have a separate metering device and be billed in their own name.

## **Participation**

Participation in the UTAP was voluntary for all DOD personnel. To participate, eligible personnel must provide a copy of their stationing orders and their rental contract (or bill of sale) to a TRO and pay the required enrollment fee. The enrollment fee was \$77 for personnel registering at one of the 16 Army TRO locations and \$35 or \$51 (depending on rank) for personnel registering at one of the two Air Force TRO locations. Upon UTAP enrollment, the TRO places an order for tax-free service with the utility provider. DOD personnel who do not order tax-free utility service through the TRO are ineligible for tax relief.

## ***Housing Related Allowances***

DOD personnel stationed in foreign areas may receive an allowance covering the majority of their housing related expenses. Military personnel who live off-post receive an Overseas Housing Allowance, which includes the actual cost of rent<sup>3</sup> up to the maximum amount allowed and a fixed amount for utilities and recurring maintenance expenses. DOD civilians receive Living Quarters Allowance (LQA), which is designed to cover the actual cost for rent, utilities, and other expenses required by law or custom up to the maximum allowable LQA amount.

## **Benefits of Participation in the UTAP**

Participation in UTAP allows DOD personnel to avoid paying VAT on their residential utilities. Since DOD provides military members a fixed amount for their utility costs as part of their Overseas Housing Allowance, the service member may save as a result of their participation in UTAP. However, since DOD reimburses civilian employees for actual utility costs, DOD benefits from civilian employee participation through reduced LQA payments. For the purpose of our audit, we focused on DOD civilians that receive LQA since their participation in UTAP yields cost savings for the U.S. Government.

## **LQA Process**

To initiate LQA reimbursements, DOD civilians must complete the Standard Form 1190, “Foreign Allowances Application, Grant and Report,” and a worksheet that itemizes the rent or purchase price, estimated utility costs, and other expenses. The paying office uses this worksheet to determine the amount of LQA paid to each civilian employee. Even though the DOD benefits when LQA recipients participate in UTAP, the reimbursement forms do not identify the UTAP enrollment fee as a reimbursable expense. Currently, if an LQA recipient decides to participate in UTAP, the employee must use his or her personal funds to pay the UTAP enrollment fee.

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<sup>3</sup> Rent includes the amount paid for a leased off-post residence or an amount calculated as assumed rent for a personally owned residence.

The LQA amount paid to civilian personnel during their first year residing in off-post housing is based on estimated costs. DOD policy requires civilian employees to provide receipts for all utilities to support actual costs for LQA reconciliation. However, DOD Components establish procedures for processing LQA reconciliations and time frames for completing them. The Army, Air Force, and DOD Education Activity (DODEA) require civilians to submit receipts for all utilities for LQA reconciliation within 12 to 15 months of moving into a new off-post residence. Offices responsible for administering the LQA use these receipts to determine the actual costs and base the LQA amounts for future years on these actual costs. For example, if a civilian employee estimated that her rent would be \$2,000 per month and her utility costs would be \$400 per month, she would receive \$2,400 per month during her first year in off-post housing. If the actual costs were \$2,000 for rent and \$500 for utilities, she would receive a lump-sum reimbursement of \$1,200 and \$2,500 per month for all future years.

## **Review of Internal Controls**

DOD Instruction 5010.40, “Managers’ Internal Control Program Procedures,” January 4, 2006, requires DOD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of controls. We reviewed policies and procedures pertaining to the oversight of the UTAP in Germany. The UTAP internal controls were effective and we identified no internal control weaknesses.

## Finding. DOD Can Improve Participation in the Utility Tax Avoidance Program

DOD was not effectively using the UTAP in Germany. Specifically, not all eligible civilian personnel stationed in Germany participated in the UTAP. For example, 124 eligible individuals in a sample of 244 Army civilians receiving LQA in both March 1, 2008, and February 28, 2009, pay periods did not participate in the program. This occurred because DOD did not require eligible civilian personnel to participate in the program. As a result, DOD is not maximizing foreign tax savings in accordance with DOD Instruction 5100.64.

### DOD Civilians Receiving Living Quarters Allowance in Germany

During the 12-month period ending February 28, 2009, 7,596 DOD civilian employees stationed in Germany received approximately \$259 million in total LQA payments. Of

*Of the 7,596 DOD civilian employees receiving LQA payments, 7,214 received utility cost reimbursement totaling approximately \$58 million.*

the 7,596 DOD civilian employees receiving LQA payments, 7,214 received utility cost reimbursement totaling approximately \$58 million. Employees do not receive utility cost reimbursement for several reasons, such as when utility

expenses are included in the rent or when the rental portion of LQA exceeds the maximum allowance. Table 1 shows the total LQA and utility-related costs for these civilians.

**Table 1. DOD Civilian LQA Costs in Germany**

(Data obtained from Defense Financial Accounting Service records of LQA payments)

Employing Activity	Number of Civilian Employees Receiving LQA	Total LQA Amount	Number of Civilian Employees Receiving Utility Cost Reimbursement	Utility-related Costs
Army	4,169	\$132,735,153	3,950	\$33,914,091
Air Force	597	24,392,336	588	5,626,024
DODEA	2,129	76,424,165	2,024	13,292,129
Other	701	25,157,593	652	5,220,346
<b>Total</b>	<b>7,596</b>	<b>\$258,709,247</b>	<b>7,214</b>	<b>\$58,052,590</b>

### Voluntary Nature of Program Limits Utility Tax Avoidance Program Participation

Although the UTAP was an effective way for DOD to maximize foreign tax savings, the voluntary nature of the program limited DOD civilian participation. Making the UTAP

mandatory for eligible civilians as a condition of receiving LQA and reimbursing the enrollment fee would increase participation and DOD savings.

We reviewed the participation rates for a statistical sample of DOD civilians for which actual utility costs could be determined. LQA payments for the first year a DOD civilian resided in off-post housing were based on estimated expenses. Actual utility costs were not known until an LQA reconciliation was performed 12 to 15 months after the civilian moved into a new off-post residence. The substantiating documentation that DOD civilians submitted for the reconciliation included actual electric, gas, and water bills. Because there was no standard form on which to document UTAP eligibility and participation, we relied on the utility bills to determine actual utility expenses, eligibility for participation in the UTAP, and participation rates. This documentation was only available for DOD civilians who had completed an annual LQA reconciliation. Implementing a standard form that documents UTAP eligibility and participation would assist personnel offices in verifying that all eligible civilians participate in the UTAP.

To ensure that civilians in the statistical sample completed an LQA reconciliation, we limited the population to DOD civilians who received LQA utility payments in both the March 1, 2008, and February 28, 2009, pay periods. Of the 7,596 DOD civilians who received LQA, only 5,531 received LQA payments in both March 1, 2008, and February 28, 2009, pay periods. We used these 5,531 civilians as the population from which to select a sample. This population included DOD civilians employed by the Army, Air Force, DODEA, and other DOD Agencies. However, the Air Force and DODEA personnel offices did not maintain the actual utility bills for enough civilian employees for us to use this statistical sample. In addition, we were unable to locate the servicing personnel offices for some of the remaining civilians who worked for DOD agencies with only a small number of employees stationed in Germany.

The Army Civilian Human Resources Agency was the only office that maintained the actual utility bills for a sufficient number of civilian employees for us to statistically sample. Therefore, we revised our DOD civilian population to include only those

*DOD spent over \$26 million on utility-related costs for 2,438 Army civilians during the 12-month period ending February 28, 2009.*

civilians employed by the U.S. Army. Of the 4,169 Army civilians in Germany, only 2,438 received LQA utility payments in both the March 1, 2008, and February 28, 2009, pay periods. DOD spent \$26,057,989 on utility-related costs for

these civilians during the 12-month period ending February 28, 2009. We selected a statistical sample of 244 civilian employees from the population of 2,438. See Appendix C for details of our statistical analysis.

We obtained the utility bills for the statistically sampled civilians from the Army Civilian Human Resources Agency - Europe Region and North Central Region, which performed LQA reconciliations for Army civilians in Europe. We used these utility bills to determine whether civilians in our sample were eligible to participate in UTAP and whether they participated. Table 2 presents the results of our analysis of records of the

244 individuals in our sample of Army civilians receiving LQA during the March 1, 2008 and February 28, 2009 pay periods. The table shows the number eligible for UTAP, the number of eligible personnel not participating, and the annual VAT paid by the Army for those individuals not participating in UTAP for each utility.

**Table 2. UTAP Eligibility and Non-Participation Data for Sampled Army Civilians Receiving LQA in March 1, 2008 and February 28, 2009 Pay Periods**

Utility	Sample Size	Eligibility	Eligible Army Civilians Not Participating	Annual VAT Paid For Non Participants (Dollars)
Electricity	244	226	124	\$35,313
Natural Gas	244	96	39	15,230
Water	244	52	22	698
<b>Total</b>				\$51,241

For electricity, 18 of the 244 Army civilians were not eligible to participate in the UTAP because the utility bill was in the landlord's name or a participating UTAP company does not service their address. According to our review of LQA records, only 102 of the 226 eligible civilians participated in the UTAP to receive tax-free electricity. For the 12-month period ending February 28, 2009, DOD paid \$35,313 in VAT for the 124 sampled eligible individuals not participating in the program.

For natural gas, 148 of the 244 Army civilians were not eligible to participate in the UTAP because the utility bill was in the landlord's name, the residence had a heat source other than natural gas, or a participating UTAP company does not service their address. According to our review of LQA records, only 57 of the 96 eligible civilians participate in the program. For the 12-month period ending February 28, 2009, DOD paid \$15,320 in VAT for the 39 sampled eligible individuals not participating in the program.

For water, 192 of the 244 Army civilians were not eligible to participate in the UTAP because the utility bill was in the landlord's name or a participating UTAP company does not service their address. According to our review of LQA records, 30 of the 52 eligible civilians participate in the program. For the 12-month period ending February 28, 2009, DOD paid \$698 in VAT for the 22 sampled eligible individuals not participating.

With assistance from the DOD Office of Inspector General Quantitative Methods and Analysis Division, we projected the results from our 244 sample items to the population of 2,438 civilians. Table 3 shows the results of this projection. See Appendix C for detailed projections.



**Table 3. Projected UTAP Eligibility and Non-Participation Rates  
for All Army Civilians**

Utility	Population	Eligibility		Eligible Army Civilians Not Participating		Annual VAT Paid (Dollars)
Electricity	2,438	2,258	93 percent	1,239	55 percent	\$352,842
Natural Gas	2,438	960	39 percent	390	41 percent	152,182
Water	2,438	520	21 percent	220	42 percent	6,995
<b>Total</b>						<b>\$512,019</b>

Eligible civilians who did not participate in the UTAP cost the DOD \$512,019 between March 2008 and February 2009. Specifically, DOD unnecessarily paid \$352,842 in foreign taxes on electricity due to a civilian participation rate of 45 percent, \$152,182 in foreign taxes on natural gas due to a civilian participation rate of 59 percent, and \$6,995 in foreign taxes on water due to a civilian participation rate of 58 percent.

### Potential Savings to DOD

DOD could prevent overpayment of foreign taxes every year by mandating participation in the UTAP for eligible DOD civilians. By making participation in the UTAP

*For the sample population...the net potential monetary benefit could be at least \$468,283 per year or \$2.8 million over the Future Years Defense Program (FYs 2011 through 2016).*

mandatory, DOD would reimburse civilians for the one-time required enrollment fee of \$77 (current maximum). For the sample population of 2,438, we estimated the cost of this enrollment fee reimbursement at \$43,736 per year. This cost represents a 25 percent employee

turnover each year (610 civilians) and a 93 percent eligibility rate in the UTAP. The net potential monetary benefit could be at least \$468,283 per year or \$2.8 million over the Future Years Defense Program (FYs 2011 through 2016). Because the Air Force and DODEA did not maintain the documentation we required for statistical sampling, the above calculation is based on approximately one-third (2,438) of the DOD civilians receiving LQA payments (7,596) during the 12-month period ending February 28, 2009. See Appendix D for summary of potential monetary benefits.

### Potential for Fraud

Employees may have an opportunity to defraud the U.S. Government of LQA funds since

*Since DOD does not require eligible LQA recipients to participate in UTAP, employees may have an opportunity to defraud the U.S. Government of LQA funds.*

DOD does not require eligible LQA recipients to participate in the UTAP as a prerequisite for receiving LQA payments. As mentioned previously, DOD determines future LQA payments

based on the actual expenses incurred during their first 12 months in off-post housing. Thus, if an LQA recipient registers for the UTAP after the reconciliation occurs, the LQA

amount received in subsequent years would include the VAT paid by DOD during the first year. For the remaining time overseas, the LQA recipient would then profit from the difference between the tax-free utility costs and the amount reimbursed by DOD based on the initial taxable utility costs. Implementation of our recommendation to require participation of eligible participants in the UTAP prior to the receipt of LQA funds would eliminate the possibility of this potential fraud.

## **Conclusion**

DOD essentially relinquished control of the ability to maximize foreign tax savings by leaving the decision to join the UTAP to the individual DOD civilian employee. Our sample results show that DOD is not securing the maximum foreign tax relief possible. Participation may be lower in a voluntary program, particularly when participation requires a civilian employee to expend personal funds to save the Government money. Making the UTAP mandatory for eligible civilians as a condition of receiving LQA and reimbursing the enrollment fee for participation would increase participation and DOD savings.

## **Recommendations, Management Comments, and Our Response**

**Redirected and Renumbered Recommendations.** As a result of management comments, we redirected Draft recommendation 2 to the Under Secretary of Defense of Personnel and Readiness. As a result, Draft Recommendations 1.a., 1.b. and 2 have been renumbered as Recommendations 1, 2, and 3, respectively.

**We recommend that the Under Secretary of Defense for Personnel and Readiness:**

**1. Develop regulatory guidance requiring civilian personnel agencies to withhold the living quarters allowance until a recipient(s) submits proof of participation or ineligibility in the utility tax avoidance program.**

### ***Under Secretary of Defense for Personnel and Readiness Comments***

The Under Secretary of Defense for Personnel and Readiness (the Under Secretary), agreed with the primary finding of the report; that because the Utility Tax Avoidance Program is not mandatory, DOD activities are not maximizing foreign tax savings, and that regulatory guidance should be issued to make the program mandatory wherever it is available. The Under Secretary stated that draft recommendation 1.a. (final recommendation 1) is more stringent than necessary because it withholds funds for living quarters expenses beyond just utilities. He suggested that a more reasonable rule would be to withhold the utilities portion of LQA until the employee participates in the program. In order to implement this recommendation, his office will issue regulatory guidance making the Utility Tax Avoidance Program mandatory for all eligible employees. This action will be completed by December 31, 2010.

## ***Our Response***

The comments provided by the Under Secretary were responsive and meet the intent of the recommendation. No additional comments are required for this recommendation.

**2. Develop regulatory guidance reimbursing living quarters allowance recipients for the enrollment fee.**

## ***Under Secretary of Defense for Personnel and Readiness Comments***

The Under Secretary disagreed with our recommendation to reimburse the enrollment fee as a separate expense. He stated that the Joint Travel Regulation authorizes a Miscellaneous Expense Allowance to reimburse civilian employees for various costs associated with a permanent change of station move including “disconnecting/connecting appliances, equipment, and utilities involved in relocation.” The Under Secretary cited that the UTAP enrollment fee is covered by the Miscellaneous Expense Allowance as a cost for connecting utilities.

## ***Our Response***

The comments provided by the Under Secretary were responsive and meet the intent of the recommendation. Using funds provided as part of the Miscellaneous Expense Allowance will alleviate the need to separately reimburse living quarters allowance recipients for enrolling in the tax avoidance program. No additional comments are required for this recommendation.

**3. Develop a standard form for tax relief offices to complete, which will verify living quarters allowance recipients’ participation or ineligibility in the utility tax avoidance program in coordination with the U.S. Army Installation Management Command - Europe Region.**

## ***Regional Director, U.S. Army Installation Management Command - Europe Region Comments***

The Regional Director agreed in principle to draft recommendation 2 (final recommendation 3). The Regional Director agreed that a standard form documenting UTAP participation should be documented and used; however, the Regional Director recommended that draft recommendation 2 be redirected to an office responsible for setting policy for matters associated with LQA, such as the Under Secretary of Defense for Personnel and Readiness. The Regional Director also provided a sample form for DOD to use as a basis for the development of a standard form for documenting UTAP participation.

### ***Our Response***

The Regional Director, U.S. Army Installation Management Command - Europe Region, comments were responsive. We have redirected draft recommendation 2 (final recommendation 3) to the Under Secretary of Defense for Personnel and Readiness and requested that they provide a response by October 29, 2010.

## Appendix A. Scope and Methodology

We conducted this performance audit from February 2009 through May 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To evaluate the effectiveness of the UTAP, we first determined how many DOD civilians were receiving LQA payments in Germany. The Defense Finance and Accounting Service (DFAS) provided a listing of all LQA payments made to 7,596 DOD civilians living in Germany from March 1, 2008, to February 28, 2009. This listing included DOD civilians employed by the Army, Air Force, DODEA, and other DOD agencies. However, the Air Force and DODEA personnel offices did not maintain the actual utility bills for enough civilian employees for us to use statistical sampling. In addition, we were unable to locate the servicing personnel office for some of the remaining civilians who worked for DOD agencies with only a small number of employees stationed in Germany. Therefore, we limited our scope to Army civilians because they were the only group for who all necessary documentation was available.

Next, we determined utility costs, eligibility rates, and participation rates by reviewing LQA reconciliation paperwork. We extracted Army civilians who received an LQA payment in both March 1, 2008, and February 28, 2009, pay periods. This produced a universe of 2,438 Army civilians receiving \$26,057,989 in utility-related payments for the period. We selected a sample of 244 Army civilians using statistical sampling techniques. For each of the 244 Army civilians in our sample, we gathered LQA reconciliation documents from U.S. Army Civilian Human Resources Agency - European Region and U.S. Army Civilian Human Resources Agency - North Central Region. We also gathered information regarding the utility companies who participate in UTAP from IMCOM-E and USAFE UTAP offices. After analyzing this information, we were able to determine actual utility expenses, eligibility for participation in the UTAP, and participation rates. We based our projections, including potential monetary benefits, on our universe of 2,438 Army civilians. See Appendix C for statistical sampling information.

We requested data from the DFAS in March 2009; however, valid usable data was not provided until June 2009. The delay was due to DFAS personnel having to write system queries in order to extract the needed information and our making multiple requests upon receipt of erroneous data.

We reviewed the status of forces agreement and guidance from DOD, U.S. European Command, and U.S. Army Europe. Specifically, we reviewed DOD Instruction 5100.64, "DOD Foreign Tax Relief Program," March 30, 2006; U.S. European Command Directive 45-8, "Foreign Tax Relief Program," May 7, 2007; U.S. Army in Europe Regulation 215-6 (also known as U.S. Air Force Europe Instruction 34-102), "Individual Tax Relief Program," August 3, 2009; U.S. Army Regulation 27-70, "DOD Foreign Tax

Relief Program,” January 15, 1980; and North Atlantic Treaty Organization Status of Forces Agreement Supplementary Agreement, Article 67 and 68, March 29, 1998.

We reviewed policies and procedures pertaining to the oversight of the UTAP in Germany. The UTAP internal controls were effective, and we identified no internal control weaknesses. The finding and recommendations contained in this report address converting the UTAP program from voluntary-based participation to mandatory participation.

Some figures in this report have been converted from Euros (€) to U.S. Dollars (\$) for ease of comparison and understanding. We used an average daily exchange rate for the time period of our data (March 2008 – February 2009) of €1 = \$0.69704 for this conversion.

## **Use of Computer-Processed Data**

We used computer-processed data obtained from the DFAS Defense Civilian Pay System database. We tested the reliability and accuracy of the listing of personnel receiving LQA in Germany by comparing sampled items to hard-copy records obtained from the U.S. Army Civilian Human Resources Agency. Nothing came to our attention as a result of the specified procedures that caused us to doubt the reliability of the computer-processed data.

## **Use of Technical Assistance**

The DOD Inspector General (DOD IG) Quantitative Methods and Analysis Division assisted with the audit. See Appendix C for detailed information about the work performed. In addition, we received legal opinions from the DOD IG and U.S. Army Europe regarding the legality of our recommendation to make UTAP mandatory.

## **Prior Coverage**

During the last 5 years, the DOD IG has issued one report addressing issues related to DOD foreign tax relief policies and UTAP. Unrestricted DOD IG reports can be accessed at <http://www.dodig.mil/audit/reports>.

### ***DOD IG***

DOD IG Report No. D-2010-030, “Utility Tax Relief Program in the Netherlands,” January 6, 2010

# **Appendix B. Foreign Tax Relief Criteria**

## **DOD**

The DOD Financial Management Regulation, 7000.14-R, vol 10, ch 6, “Federal, State, Local, and Foreign Taxes,” February 1996, states that the U.S. Government’s right to foreign tax exemptions is based on the tax agreements with foreign countries, which are outlined in the Status of Forces or Government tax agreements.

DOD Instruction 5100.64, “DOD Foreign Tax Relief Program,” March 30, 2006, prescribes the policies and procedures of the DOD foreign tax relief program, requiring that DOD secure, to the maximum extent possible, effective relief from all foreign taxes wherever the ultimate economic burden of those taxes would, in absence of such relief, be borne by funds appropriated or allocated to the DOD or under the control of its non-appropriated fund activities. Further, DOD Instruction 5100.64 states that when the cost of effective tax relief outweighs the benefit to be obtained, tax relief should be considered impractical.

## **U.S. European Command**

As an extension to the DOD Instruction, Headquarters U.S. European Command Directive 45-8, “Foreign Tax Relief Program,” May 8, 2007, assigned the Commander, U.S. Army Europe as the designated Military Commander for the purposes of the Foreign Tax Relief Program in Germany.

To provide policy and procedures for administering tax-free purchases of goods and services in Germany, the designated Military Commander in conjunction with the Commander, USAFE issued a joint publication Army in Europe Regulation 215-6/ USAFE Instruction 34-102, “Morale, Welfare, and Recreation Individual Tax Relief Program,” August 3, 2009. The guidance covers only goods and services in the local German communities as provided for by the status of forces agreement to official U.S. forces procurement agencies, but not to individuals. IMCOM-E Community Morale, Welfare, and Recreation Fund and USAFE Services Fund activities, as official procurement agencies, are able to provide exemption from VAT when they act as a purchasing activity on behalf of authorized members of the U.S. Forces and the civilian component. When the German utility company participates in the tax relief program, the goods and services may be procured tax-free through the IMCOM-E Community Morale, Welfare, and Recreation Fund and the USAFE Services Fund operations; provided that the transaction is properly conducted and the purchase is not prohibited.

## **North Atlantic Treaty Organization**

Article 67 of the North Atlantic Treaty Organization Status of Forces Agreement Supplementary Agreement, March 29, 1998, addresses taxation and customs duties for goods and services rendered to foreign forces stationed in the Federal Republic of Germany. Specifically, tax relief shall be granted when goods or services are procured by an official procurement agency of a force or a civilian component for the use of, or consumption by, the force, the civilian component, their members, or dependents. A



letter from the German Federal Ministry of Finance, December 22, 2004, clarified Article 67. The letter states, “Turnover tax/VAT (value added tax) relief pursuant to Article 67, paragraph 3, the North Atlantic Treaty Organization Status of Forces Agreement Supplementary Agreement is also possible for the supply of electricity, gas, water, and heat.”

## Appendix C. Technical Assistance

We requested assistance from the DOD OIG Quantitative Methods and Analysis Division to project our sample results to the 2,438 Army civilians in the population. The projections were computed using 95 percent confidence levels. Each line of projection provides the point estimate with associated lower and upper bounds for the relevant measure.

We list the statistical projections provided in the two following tables. The first table (C1) lists eligibility and participation values related to each utility (electric, gas and water). The first section provides data related to electricity. The first row shows that between 876 and 1163 households are eligible for and participate in the UTAP. The point estimate of 1,019 households equates to approximately 42 percent of the total population. The remaining rows and sections can be interpreted in the same manner.

The second table (C2) lists total costs for each utility and the taxes saved by participants or incurred by non-participants. The first section provides data related to electricity. The first row shows that DOD spent between €2,197,683 (\$3,152,879) and €2,199,982 (\$3,156,178) for electricity for Army civilians in the population. The second row of data shows that UTAP participants save DOD between €143,440 (\$205,784) and €200,220 (\$287,243) annually. The third row of data shows that eligible non-participants cost DOD between €207,964 (\$298,353) and €283,927 (\$407,332) annually. The fourth row of data shows that DOD could save between €385,433 (\$552,957) and €450,118 (\$645,756) annually if UTAP participation increased to 100 percent. The remaining sections can be interpreted in the same manner.

**Table C1. Statistical Projections – Number of Households**

<b>Electric</b>	<b>Point Estimate</b>	<b>Lower Bound</b>	<b>Upper Bound</b>
Eligible - Participating	1,019	876	1,163
Eligible - Non Participating	1,239	1,094	1,384
Total Eligible	2,258	2,182	2,334
Total Non Eligible	180	104	256
<b>Gas</b>	<b>Point Estimate</b>	<b>Lower Bound</b>	<b>Upper Bound</b>
Eligible - Participating	570	446	693
Eligible - Non Participating	390	283	496
Total Eligible	960	817	1,101
Total Non Eligible	1,479	1,337	1,621
<b>Water</b>	<b>Point Estimate</b>	<b>Lower Bound</b>	<b>Upper Bound</b>
Eligible - Participating	300	204	395
Eligible - Non Participating	220	137	303
Total Eligible	520	400	639
Total Non Eligible	1,918	1,799	2,038

**Table C2. Statistical Projections – Utility Costs And Taxes**  
(Values Presented in Euros and Dollars)

<b>Electric</b>	<b>Point Estimate</b>		<b>Lower Bound</b>		<b>Upper Bound</b>	
	Euros	Dollars	Euros	Dollars	Euros	Dollars
Total Utility Cost	€2,198,832	\$3,154,528	€2,197,683	\$3,152,879	€2,199,982	\$3,156,178
<b>Utility Tax Values (19 percent tax rate)</b>						
	Euros	Dollars	Euros	Dollars	Euros	Dollars
Eligible - Participating	€171,830	\$246,514	€143,440	\$205,784	€200,220	\$287,243
Eligible - Non Participating	245,945	352,843	207,964	298,353	283,927	407,332
Total Eligible	417,776	599,357	385,433	552,957	450,118	645,756
<b>Gas</b>	<b>Point Estimate</b>		<b>Lower Bound</b>		<b>Upper Bound</b>	
	Euros	Dollars	Euros	Dollars	Euros	Dollars
Total Utility Cost	€1,464,848	\$2,101,526	€1,094,587	\$1,570,335	€1,835,109	\$2,632,717
<b>Utility Tax Values (19 percent tax rate)</b>						
	Euros	Dollars	Euros	Dollars	Euros	Dollars
Eligible - Participating	€172,245	\$247,109	€110,858	\$159,041	€233,631	\$335,176
Eligible - Non Participating	106,077	152,183	59,393	85,207	152,762	219,158
Total Eligible	278,322	399,291	207,974	298,367	348,671	500,216
<b>Water</b>	<b>Point Estimate</b>		<b>Lower Bound</b>		<b>Upper Bound</b>	
	Euros	Dollars	Euros	Dollars	Euros	Dollars
Total Utility Cost	€166,296	\$238,574	€109,816	\$157,546	€222,776	\$319,603
<b>Utility Tax Values (7 percent tax rate)</b>						
	Euros	Dollars	Euros	Dollars	Euros	Dollars
Eligible - Participating	€6,778	\$9,274	€3,464	\$4,970	€10,091	\$14,477
Eligible - Non Participating	4,876	6,995	2,419	3,471	7,333	10,520
Total Eligible	11,654	16,719	7,700	11,046	15,608	22,391

## Appendix D. Summary of Potential Monetary Benefits

<u>Recommendations</u>	<u>Type of Benefit</u>	<u>Amount of Benefit</u>	<u>Account(s)</u>
1, 2, and 3.	Funds put to better use. Avoidance of foreign taxes on utility-related LQA payments.	\$2.8 million	Army Operations

# Under Secretary of Defense for Personnel and Readiness Comments

Final Report  
Reference



PERSONNEL AND  
READINESS

UNDER SECRETARY OF DEFENSE  
4000 DEFENSE PENTAGON  
WASHINGTON, D.C. 20301-4000

AUG 2 2010



MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Utility Tax Avoidance Program in Germany (Project No. D2009-D000JB-0144.001)

This responds to an Inspector General May 21, 2010 memorandum regarding the Utility Tax Avoidance Program in Germany, and provides our comments on the Project Report. This office concurs with the report's basic finding; that because the Utility Tax Avoidance Program is not mandatory, DoD activities are not maximizing foreign tax savings, and that regulatory guidance should be issued to make the program mandatory wherever it is available. The following comments are provided to the report's recommendations.

Recommendation 1.a. Requiring civilian personnel agencies to withhold the living quarters allowance (LQA) until a recipient submits proof of participation in or ineligibility for the Utility Tax Avoidance Program.

Comments: The Office of the Under Secretary for Personnel & Readiness (OUSD (P&R)) believes the recommendation is more stringent than it needs to be because it withholds funds for living quarters expenses beyond just utilities. A more reasonable rule would be to withhold the utilities portion of LQA until the employee participates in the program.

Recommendation 1.b. Reimbursing living quarters allowance recipients for the enrollment fee.

Comments: The Joint Travel Regulation (JTR) in paragraph C5310 authorizes a Miscellaneous Expense Allowance (MEA) to reimburse civilian employees for various costs associated with a permanent change of station move including "disconnecting/connecting appliances, equipment, and utilities involved in relocation." In this office's view, in a mandatory program, the enrollment fee would be considered a cost for connecting to utilities, and thus is covered by the MEA. The MEA is reimbursed to the employee at a flat rate, generally \$500 without dependents or \$1,000 with dependents, as applicable. The JTR authorizes payments above the flat rate, up to a maximum of the employee's one-week (without dependents) or two-week (with dependents) salary, but the employee must provide receipts to show those increased expenses.

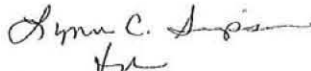
Renumbered as  
Recommendation 1.

Renumbered as  
Recommendation 2.



OUSD (P&R) understands that a deregulation policy for energy providers in Germany has been implemented, resulting in a more competitive energy market. Thus, the Utility Tax Avoidance Program can be presented to the German utility companies in DoD's position as a "bulk buyer" of energy, and thus qualify for lower energy rates, in addition to being free of value added tax. Therefore, the potential savings may exceed the relief described in the Inspector General Report.

In order to implement Recommendation 1.a., this office will issue regulatory guidance making the Utility Tax Avoidance Program mandatory for all eligible employees. This action will be completed by December 31, 2010.

  
Clifford L. Stanley



# U.S. Army Installation Management Command – Europe Region Comments



DEPARTMENT OF  
DEFENSE

DEPARTMENT OF THE ARMY  
US ARMY INSTALLATION MANAGEMENT COMMAND  
2511 JEFFERSON DAVIS HIGHWAY  
ARLINGTON, VA 22202-3926

IMCG

JUN 24 2010

MEMORANDUM FOR Office of the Inspector General, Department of Defense,  
400 Army Navy Drive, Arlington, VA 22202

SUBJECT: Audit of Utility Tax Avoidance Program in Germany (Project No. D2009-  
D000JB-0144.001)

1. References:

a. DODIG Report, Audit of Utility Tax Avoidance Program in Germany,  
May 21, 2010 (enclosure 1).

b. Memorandum, IMEU-IR, 17 June 2010, subject: Command Reply, DODIG Draft  
Report, Audit of Utility Tax Relief Program in Germany (enclosure 2).

2. The US Army Installation Management Command (IMCOM) has reviewed the  
subject draft report and the IMCOM-Europe command comments. The actions taken by  
IMCOM-Europe address the applicable recommendation made by your office. IMCOM  
concurs with the recommendation and corrective actions

3. The Internal Review point of contact is [REDACTED]

2 encls

RICK LYNCH  
Lieutenant General, USA  
Commanding



DEPARTMENT OF THE ARMY  
UNITED STATES ARMY INSTALLATION MANAGEMENT COMMAND  
EUROPE REGION  
UNIT 29353, BOX 200  
APO AE 09014-0200

IMEU-IR

10A 17200

MEMORANDUM FOR Commander, United States Army Installation Management Command,  
2511 Jefferson Davis Highway, Arlington, VA 22202-3926

SUBJECT: Command Reply, DODIG Draft Report, Audit of Utility Tax Relief Program in  
Germany (Project No. D2009-D000JB-0144.001)

1. IMCOM-Europe has reviewed the subject draft report and concurs with comments to the  
recommendation, conclusions, and discussions. Specific comments concerning the  
recommendation and target date are enclosed.

2. The POC is [REDACTED]

Encl

DIANE M. DEVENS  
Director

Encl 2

**IMCOM-Europe Reply to  
Draft DODIG Report for  
Utility Tax Avoidance Program in Germany  
(Project No. D2009-D00JB-0144.001)**

**UTILITY TAX AVOIDANCE PROGRAM PARTICIPATION**

**Objective:** To determine whether DOD is effectively using the Utility Tax Avoidance Program (UTAP) in Germany.

**Conclusion:** DOD has not effectively used the UTAP in Germany. Not all eligible civilian personnel stationed in Germany have participated in the UTAP. During the 1 March 2008 and 28 February 2009 pay periods, 124 eligible individuals in a sample of 244 Army civilians receiving living quarters allowance (LQA) did not participate in the program. This occurred because DOD did not require all eligible Army civilian personnel to participate in the program. As a result, DOD is not maximizing foreign tax savings in accordance with DOD Instruction 5100.64.

**For the Regional Director,  
U.S. Army Installation Management Command, Europe Region**

**Recommendation 2.** We recommend the Regional Director develop and implement a standard form for tax relief offices to complete, which will verify LQA recipients' participation or ineligibility in the utility tax avoidance program.

**Action Taken. Concur in Principle.** We agree that a standard form documenting UTAP participation should be developed and used. However, the recommendation should be redirected to the USD, Personnel and Readiness, responsible for setting policy or making discretionary decisions about UTAP participation and LQA. Attached is a sample of the form for DOD use as a basis to develop a form to meet their requirements.

Recommendation 3.

Encl

### UTAP Statement of Availability

Last Name:	Snuffy	DOB:	29. Feb. 1999
First Name:	John	SSN:	222-22-222
APO Address:	CMR 420, Box 0	Rank:	GS-13
APO AE Zip:	09063		

☒ DOD   
 ☐ Contractor (TESA)   
 ☐ Other (Explain) \_\_\_\_\_

**German Street Address:**

Address Line 1:	Hauptstrasse 56
Address Line 2:	Apt. 4
German Zip & City:	69126 Heidelberg

**Utilities Used, Availability, and Eligibility:**

Utilities in Dwelling	UTAP available in area (existing VAT contracts)	In Name of US Tenant (eligible)	In Name of Landlord (ineligible)	UTAP VAT-Free Billing Granted For:
Electricity	X	X		X
Gas			X	
Water			X	
District Heat	X		X	

Eligible DOD Service Member/Employee sign-up date: 25. May 2010

Fee Paid: \$77.00

\_\_\_\_\_  
VAT Office Signature and Stamp

**Data required by the Privacy Act of 1974 (5 USC 552):**

- a. **Authority:** 10 USC 3012; Supplementary Agreement to the NATO SOFA, Article 67, paragraph 3a(a)(i); and AE Regulation 215-6/USAFE Instruction 34-102.
- b. **Principal Purposes:** Serves as proof of mandatory UTAP enrollment or non-enrollment depending on availability for LQA purposes.
- c. **Routine Uses:** To provide information needed to process LQA and for reimbursement of sign-up fee (\$77).
- d. **Mandatory or Voluntary Disclosure and Effect of Not Providing Information:** Disclosure of information is voluntary. Utility reimbursement in conjunction with LQA, however, cannot be provided without the requested information.

AE Form 215-XX, May 2010





# Inspector General Department of Defense